

Inspector General

United States
Department of Defense



Oversight Review

June 25, 2009

Report on Quality Review of the Ernst & Young, LLP Fiscal
Year 2007 Single Audit of the University of Dayton

Report No. D-2009-6-006

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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JUN 25 2009

Chair, Board of Trustees
University of Dayton

Vice President for Finance and Administrative Services
University of Dayton

Audit Partner
Ernst & Young, LLP

SUBJECT: Report on Quality Control Review of the Ernst & Young, LLP Fiscal Year 2007
Single Audit of the University of Dayton (Report No. D-2009-6-006).

We are providing this report for your information and use. As the cognizant Federal agency for the University of Dayton we performed a review of the Ernst & Young, LLP single audit and supporting work papers for the fiscal year ended June 30, 2007, to determine whether the audit was conducted in accordance with Government Auditing Standards and the auditing and reporting requirements of Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (OMB Circular A-133). Our review of the audit of major programs was limited to the audit of the Research and Development Cluster. Appendix A contains additional background, scope and methodology for the review and Appendix B lists the compliance requirements applicable to the fiscal year 2007 audit period.

Background. The University of Dayton is an independent, educational institution located in Dayton, Ohio. The University of Dayton Research Institute performs basic and applied research and development activities under industry and government contracts and grants. Approximately 90 percent of the University of Dayton's research and development activities are for government-sponsored programs. The University of Dayton expended \$129.4 million in Federal awards for the fiscal year ended June 30, 2007 under Federal research and development and student financial aid programs. Of the \$129.4 million, \$61.5 million was expended for research and development awards, of which \$41.4 million were Department of Defense programs.

Review Results. Ernst & Young did not fully comply with OMB Circular A-133 requirements and auditing standards in the fiscal year 2007 single audit. We identified deficiencies in the performance and documentation of audit procedures for three of the nine applicable compliance requirements (Finding A). Ernst & Young did not comply with the Governmental Auditing Standards reporting requirements because the report on internal control over financial reporting did not contain a reference to the management comment letter issued to the University of Dayton's Audit Committee (Finding B). Because of these deficiencies, additional audit procedures were needed before Federal agencies could rely on the single audit to monitor and manage Federal program awards. In addition, we identified several audit areas that require

enhanced documentation for future audits. These enhancements are discussed in the “Other Matters of Interest” section of this report. The University of Dayton did not fully comply with OMB Circular A-133 requirements for the presentation of the Schedule of Expenditures of Federal Awards. In addition, the Data Collection Form was not completed in accordance with OMB Circular A-133 requirements and the Federal Audit Clearinghouse reporting instructions (Finding C).

As a result of discussions with Ernst & Young throughout our site visit, Ernst & Young agreed to immediately perform additional audit procedures to correct the deficiencies noted in our review and to revise the fiscal year 2007 audit report as needed. Between August 7, 2008 and January 14, 2009, Ernst & Young provided our office with written and verbal explanations and documentation of additional audit procedures performed. The additional audit work generally complied with OMB Circular A-133 requirements and provided sufficient evidence to support the audit conclusions and opinion on the research and development cluster program. The results of our review and Ernst & Young corrective actions are discussed in the Findings section below.

Findings

Finding A. Performance of Internal Control and Compliance Testing. The Ernst & Young auditors did not perform adequate procedures to support the conclusions on internal control over and compliance with procurement, suspension and debarment and compliance with cash management and subrecipient monitoring requirements. As a result, the audit did not provide sufficient and appropriate evidence to support the conclusions on internal control over compliance and the opinion on compliance over Federal research and development program requirements. OMB Circular A-133 requires the auditors to obtain and document an understanding of internal control over each applicable compliance requirement sufficient to plan the audit to support a low-assessed level of control risk. The auditor is then required to identify key internal controls and plan and perform tests of controls and tests of compliance sufficient to support the opinion on Federal programs.

Cash Management Compliance Testing. The Ernst & Young auditors did not perform audit procedures to determine whether the University of Dayton complied with the payment requirements in 2 CFR §215.22 for advance payments and payment requests for awards using the reimbursement method. The University of Dayton received advanced payments for approximately sixty percent of its awards under an advance payment pool agreement with the Air Force. The remaining Federal awards were paid using the cash reimbursement method. The auditors did not perform audit procedures to determine whether the interest earned on advances in excess of \$250 was reported and remitted to the appropriate agency as specified in 2 CFR §215.22. In fiscal year 2007, the University of Dayton received approximately \$25 million in advanced payments which were kept in an interest bearing account.

In addition, for awards funded using the reimbursement method, the auditors did not perform audit procedures to verify whether payment requests were based on actual cash disbursements.

Ernst & Young Corrective Actions. On November 12, 2008, Ernst & Young provided the Office of Inspector General with documentation of supplemental audit procedures performed to support their conclusions on cash management requirements. Ernst & Young performed additional testing of 25 reimbursement requests and verified that the payment requests were based on actual cash disbursements. Ernst & Young also identified interest income of \$19,320 and verified it was returned to the Department of Air Force. The auditors did not note any exceptions.

Procurement Internal Control and Compliance Testing. The Ernst & Young auditors developed an understanding of internal controls and identified key controls for testing. The auditors performed procedures to verify that procurements and subawards were not made to suspended or debarred parties. However, the workpaper documentation did not include sufficient evidence to support that Ernst & Young performed the planned testing of internal controls and tested for compliance with Federal procurement requirements in 2 CFR §215.41 through §215.48. The regulations include the requirement that the University of Dayton have procurement procedures to provide for full and open competition, and maintain procurement files to include, at a minimum, the basis for the selection, justification for lack of competition when competitive bids or offers are not obtained, and evidence to support the performance of a cost or price analyses.

Ernst & Young Corrective Actions. On November 12, 2008, Ernst & Young provided the OIG with documentation of supplemental audit procedures performed to support their conclusions on internal controls over and compliance with procurement requirements. Ernst & Young obtained a listing of 37 federally funded equipment purchase transactions greater than \$25,000. Ernst & Young selected four transactions and reviewed the vendor contract files to determine if the required Federal procurement documentation was contained in each file. The auditors did not note any exceptions.

In Ernst & Young's management response letter, the auditors state they performed supplemental audit procedures and determined that the procurement, suspension and debarment compliance requirement is not direct and material with respect to the research and development cluster for fiscal year 2007. Therefore, a review of the University of Dayton's compliance with the requirements of procurement, suspension, and debarment was not necessary. We have not reviewed the workpapers that supports these statements. Furthermore, this information should have been determined and documented in the workpapers during the planning phase of the audit.

Subrecipient Monitoring Compliance Testing. The Ernst & Young auditors did not perform sufficient audit procedures to test for compliance with 2 CFR 215.51 and OMB Circular A-133 requirements to monitor subrecipient use of Federal awards. The workpaper documentation did not evidence that Ernst & Young performed sufficient audit procedures to determine that the University of Dayton adequately monitored subrecipient activities to gain assurance that pass-through awards were used for authorized purposes and that subrecipients

complied with laws, regulations and award provisions and achieved performance goals. In addition, there was limited documented evidence of performed procedures to determine that the University of Dayton ensured subrecipients met OMB Circular A-133 audit requirements and took required actions on subrecipient audit findings, including evaluating the effect of any findings on the University of Dayton's awards.

Ernst & Young Corrective Actions. On November 12, 2008 Ernst & Young provided the Office of Inspector General with documentation of supplemental audit work performed to support their conclusions on the review of subrecipient monitoring requirements. Ernst & Young selected 8 pass-through awards and verified that the University of Dayton monitored subrecipient activity by reviewing progress reports, invoices and the most recent A-133 audit reports. The auditors did not note any exceptions.

Finding B. Government Auditing Standards Reporting Requirements. The auditors did not comply with Governmental Auditing Standards paragraph 5.09 reporting requirements because the *Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on the Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* did not include a reference to the October 1, 2007 management letter issued to the University of Dayton's Audit Committee. The management comment letter communicated information technology system control deficiencies and recommendations for improvements in system procedures and controls. Based on discussions with the Ernst & Young audit manager, the omission was due to an incorrect interpretation of firm guidance relating to types of information that should be communicated to the auditee.

In Ernst & Young's management response letter, the auditors state that the control deficiencies were insignificant. We did not see clearly documented evidence in the workpapers that supports Ernst & Young's rationale for determining the significance of these deficiencies. Furthermore, Government Auditing Standards require that sufficient detail be included in the audit documentation to provide an experienced auditor who has had no previous connection with the audit to ascertain from the documentation the evidence that supports the auditors' significant judgments and conclusions.

Finding C. Presentation of Pass-through Awards in the Schedule of Expenditures of Federal Awards and the Data Collection Form. The Schedule of Expenditures of Federal Awards and Data Collection Form were not prepared in accordance with OMB Circular A-133 requirements and Data Collection Form instructions.

Schedule of Expenditures and Federal Awards. The University of Dayton did not correctly prepare the Schedule of Expenditures and Federal Awards because the schedule did not identify pass-through awards in accordance with OMB Circular A-133 §.310 (b) 1. OMB Circular A-133 requires that for the Research and Development Cluster, total Federal awards expended be shown either by individual award or by Federal agency and major subdivision within the Federal agency. The University of Dayton presented all pass-through awards received as one line item in the Schedule of Expenditures and Federal Awards and provided details of

individual awards in Schedule B to the Schedule of Expenditures and Federal Awards. However, neither the Schedule of Expenditures and Federal Awards nor Schedule B grouped the pass-through awards by the Federal agency that funded the award. This information is required to be provided to the University by the non-Federal entity that provides the pass-through award.

Data Collection Form. The University of Dayton did not correctly prepare the Data Collection Form because they did not identify the Catalog of Federal Domestic Assistance number or the Federal agency prefix number for pass-through awards received by the University of Dayton. The University of Dayton identified all pass-through awards with a “99 Miscellaneous” code. OMB Circular A-133 §.320 (2) ix and the instructions to the Data Collection Form require that Part III, Item 9 of the Data Collection Form include the Federal agency Catalog of Federal Domestic Assistance number, or if the Catalog of Federal Domestic Assistance number is not available, the two digit Federal agency prefix code associated with the pass-through award. The “99 Miscellaneous” code should only be used for Federal agencies not listed in Appendix 1 to the Data Collection Form instructions.

Recommendations and Management Comments

Recommendation 1. We recommend that the Audit Partner, Ernst & Young, LLP:

- a. **Use the results of this quality control review to strengthen existing or implement additional quality control monitoring procedures to ensure that future single audits reports and workpapers comply with Government Auditing Standards and the audit requirements of the Office of Management and Budget Circular A-133 audit.**
- b. **Revise the appropriate audit reports in the Reporting Package, to reflect, at a minimum, the issuance of the management comment letter and the completion date of the additional audit procedures.**
- c. **Provide the revised Reporting Package and signed Data Collection Form to the University of Dayton to file with the Federal Audit Clearinghouse.**

Ernst & Young Comments: Ernst & Young’s comments were responsive and conform to requirements; no additional comments are needed.

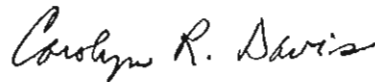
Recommendation 2. We recommend that the Vice President of Finance and Administrative Services, University of Dayton:

-
- a. **Revise the Fiscal Year 2007 Schedule of Expenditures and Federal Awards according to Office of Management and Budget A-133 requirements. Specifically, the Schedule of Expenditures and Federal Awards should identify pass-through awards received by the appropriate Federal funding agency.**
 - b. **Revise the Fiscal Year 2007 Data Collection Form according to Office of Management and Budget A-133 requirements. The Data Collection Form should identify the Catalog of Federal Domestic Assistance number or Federal agency prefix number for pass-through awards received by the University of Dayton.**
 - c. **File the revised Fiscal Year 2007 Reporting Package and signed Data Collection Form with the Federal Audit Clearinghouse and notify the Department of Defense Office of Inspector General upon completion.**

University of Dayton's Comments: The University of Dayton's comments were responsive and conform to requirements; no additional comments are needed.

Other Matters of Interest. Ernst & Young needs to enhance the audit documentation of the review of the Schedule of Expenditures and Federal Awards and the Reporting compliance requirement. We had to obtain significant additional explanations from the audit manager in order to conclude that there was sufficient evidence to support the audit conclusions and opinion on these audit areas. Government Auditing Standards require that sufficient detail be included in the audit documentation to provide an experienced auditor who has had no previous connection with the audit to ascertain from the documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should be appropriately detailed to provide a clear understanding of its purpose and source and should be appropriately organized to provide a clear link to the findings, conclusions, and recommendations.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Janet Stern at (703) 604-8750 (DSN 664-8750).



Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight

Appendix A. Quality Control Review Process

Background, Scope and Methodology

The Single Audit Act, Public Law 98-502, as amended, was enacted to improve the financial management of State and Local Governments and nonprofit organizations by establishing one uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. OMB Circular A-133 establishes policies that guide implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend at least \$500,000 or more in a year are subject to the Single Audit Act and the audit requirements in OMB Circular A-133 and therefore must have an annual single or program-specific audit performed under Governmental Auditing Standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the Ernst & Young fiscal year 2007 single audit of the University of Dayton and the resulting reporting package that was submitted to the Federal Audit Clearinghouse on March 31, 2008, using the 1999 edition of the “Uniform Quality Control Guide for the A-133 Audits” (the Guide). The Guide applies to any single audit that is subject to the requirements of OMB Circular A-133 and is the approved President’s Council on Integrity and Efficiency checklist (now referred to as The Council of Inspectors General on Integrity and Efficiency) checklist for performing single audit quality control reviews. We performed the review from July 2008 through June 2009. The review focused on the following qualitative aspects of the single audit:

- Qualification of Auditors,
- Independence,
- Due Professional Care,
- Planning and Supervision,
- Internal Control and Compliance testing,
- Schedule of Expenditures of Federal Awards, and
- Data Collection Form.

Appendix B. Compliance Requirements

OMB Circular A-133 Compliance Requirements	Applicable	Not Applicable
Activities Allowed/Unallowed	X	
Allowable Costs/Cost Principles	X	
Cash Management	X	
Davis-Bacon Act		X
Eligibility		X
Equipment and Real Property Management	X	
Matching, Level of Effort, Earmarking	X	
Period of Availability of Federal Funds	X	
Procurement, Suspension, and Debarment	X	
Program Income		X
Real Property Acquisition and Relocation Assistance		X
Reporting	X	
Subrecipient Monitoring	X	
Special Tests and Provisions		X

Ernst & Young, LLP Comments



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June 8, 2009

Ms. Carolyn Davis
Assistant Inspector General for
Audit Policy and Oversight
Inspector General
United States Department of Defense
400 Army Navy Drive (Room 833)
Arlington, Virginia 22202-4704

Response to Report on Quality Control Review of the Ernst & Young
LLP Single Audit of the University of Dayton for the Fiscal Year Ended
June 30, 2007

Dear Ms. Davis:

We are pleased to provide our response to the Quality Control Review ("QCR") of the OMB Circular A-133 Single Audit conducted by Ernst & Young LLP ("E&Y") under the Federal Single Audit Act and OMB Circular A-133 of the University of Dayton for the fiscal year ended June 30, 2007.

As an independent auditor, our overriding objective is to make certain that all aspects of our auditing and quality control processes are of high quality. This focus on quality serves the interest of the Offices of the Inspector General of the Federal Departments and Agencies that rely on audits performed under the Federal Single Audit Act and benefits the Firm.

We appreciate your comments from the QCR, and we acknowledge that your findings are helpful in highlighting areas for improvement and are being used to continue to enhance our audit processes. For example, in order to promote consistency within the firm regarding the testing of certain compliance requirements, we plan to widely distribute standard compliance testing templates for the various compliance requirements cited in your QCR report that more closely correlate to the suggested audit procedures in Part III of the *OMB Circular A-133 Compliance Supplement*.

Concurrent with your execution of the QCR, our audit documentation and procedures (appropriately dated) were enhanced in certain areas to make it more useful to you in your role as the University of Dayton's cognizant federal agency. We appreciate your acknowledgement that such work generally complied with OMB Circular A-133 and provided sufficient evidence to support the audit conclusions and opinion on the research and development cluster program. No additional findings regarding the University of Dayton's compliance with applicable requirements were noted, and the overall conclusion remained unchanged. Our report for the audit is being reissued.

We have summarized below our responses to the findings, recommendations, other matters of interest and related review results noted in your QCR report. In all cases, the matters noted reflect initial observations that were resolved subsequent to our work together.

Finding A. Performance of Internal Control and Compliance Testing

The E&Y auditors did not perform adequate procedures to support the conclusions on internal control over and compliance with Procurement, Suspension and Debarment requirements and compliance with Cash Management and Subrecipient Monitoring requirements. As a result, the audit did not provide sufficient and appropriate evidence to support the report on internal control over compliance and the opinion on compliance with Federal research and development program requirements. The report further notes instances in which limited evidence to support procedures performed was initially reflected in the working papers.

E&Y Response to Finding A

E&Y Response to Procurement Internal Control and Compliance Testing

In retrospect, Procurement, Suspension and Debarment was arguably not a direct and material compliance requirement with respect to the research and development program due to the relatively low applicable expenditures. Notwithstanding this point, we supplemented our procedures and documentation to address this matter.

To the extent that procurement is not a direct and material compliance requirement, internal control testing and compliance audit procedures did not have to be performed for procurement with respect to the research and development cluster major program. We acknowledge that we should have correctly made and documented that determination when planning the audit.

The component of fiscal year ended June 30, 2007 research and development expenditures related to purchases of over \$25,000 for which procurement compliance requirements apply is only \$2,423,114 or 3.9% of the federal expenditures on the Schedule of Expenditures of Federal Awards ("SEFA") for research and development based on the University of Dayton supplied spreadsheet.

E&Y Response to Cash Management and Subrecipient Monitoring Compliance Testing

We supplemented our documentation and procedures to address these matters.

Finding B. Government Auditing Standards Reporting Requirements

The auditors did not comply with GAS paragraph 5.09 reporting requirements because the Report on Internal Control over Financial Reporting and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a reference to the October 1, 2007 management letter issued to the University of Dayton's Audit Committee. The management comment letter communicated information technology system control deficiencies and recommendations for improvements in system procedures and controls. Based on discussions with the E&Y audit manager, the omission was due to an incorrect interpretation of firm guidance relating to types of information that should be communicated to the auditee.

E&Y Response to Finding B

All of the items in the management letter are insignificant control deficiencies related to information technology controls. Control deficiencies that are not considered significant deficiencies or material weaknesses are by their definition considered insignificant control deficiencies that have an inconsequential effect on the financial statements. Control deficiencies that have an inconsequential effect on the financial statements are not required to be communicated in writing in the management letter as it is a matter of professional judgment as to how auditors communicate these matters. We voluntarily chose to report these items in the management letter to the University of Dayton. We acknowledge that we could have documented in the working papers our rationale for why these control deficiencies were not significant deficiencies and material weaknesses in a clearer fashion. Notwithstanding the conclusion that such matters did not rise to the level of a significant deficiency, we have included a reference in our report on reissuance to such management letter.

We wish to note that while the manager is an integral part of our audit team, she did not speak for the Firm, and she was clearly mistaken in indicating that our lack of a reference to the management letter was a misinterpretation of Firm policy as you assert.

E&Y Response to Other Matters of Interest

We concur with the comment. We agree to enhance the audit documentation of the review of the SEFA and the related Reporting Compliance requirement. Please note that issues with respect to the auditor's documentation of their audit procedures with respect to the SEFA was a common deficiency in the President's Council for Integrity and Efficiency Report on National Single Audit Sampling Project that was issued on June 21, 2007. As a result, the AICPA established a task force entitled *SEFA Reporting Issues*. E&Y has been actively monitoring the activities of this task force. The task force is expected to issue an illustrative audit program to assist auditors in documenting the procedures performed on the SEFA. Subsequent to its issuance, E&Y anticipates that it will integrate this audit program into our Firm guidance with respect to performing OMB Circular A-133 audits.

E&Y Response to Recommendation 1a

We agree with the recommendation. We wish to note that E&Y has an established quality control monitoring process for Office of Management and Budget Circular A-133 audit reports and work papers to ensure that these audits comply with all applicable professional standards.

E&Y continuously evaluates our quality control monitoring process to determine that Single Audits comply with Government Auditing Standards and the audit requirements of the Office of Management and Budget Circular A-133 audit. Some aspects of this process are:

- An annual internal inspection program (Assurance Quality Review or AQR) that assesses the quality of our audit work for a cross-section of engagements, which includes Single Audits. As a requirement of membership in the AICPA Governmental Audit Quality Center, Single Audits are given specific focus in our AQR program and AQRs of Single Audits are performed by reviewers with deep expertise in Single Audits. The objective of the AQR program is to evaluate the design and operating effectiveness of the firm's quality control policies and procedures for our accounting and auditing practice. The AQR program also aids our efforts to continue to identify areas where we can improve our performance or enhance our policies and procedures.
- Substantial training specific to Single Audits that goes beyond the continuing professional education requirements of *Government Auditing Standards*. Annually, E&Y holds a one day Government Auditing Standards and A-133 technical update. Federal agency inspector general officials routinely speak at these updates on matters of interest and QCR observations with respect to OMB Circular A-133 audits. Each sub-area in the firm also holds at least one annual classroom training entitled "Performing a Government Auditing Standards and OMB Circular A-133 Audit". The firm also has an extensive library of just-in time web based programs on various aspects of the Single Audit. These include four two-hour web based learning programs with respect to auditing indirect costs under the various OMB cost circulars including one two-hour course on auditing indirect costs for colleges and universities under OMB Circular A-21.
- A strong firm commitment to inform all professionals working on Single Audits of changes to relevant requirements and standards through the distribution of a monthly federal awards technical newsletter to over 1100 professionals performing Government Auditing Standards and Single Audits. These newsletters are supplemented by several conference calls each year on emerging Single Audit topics and updates.

Response to Report on Quality Control Review of the
Ernst & Young LLP Single Audit of the University of Dayton
for the Fiscal Year Ended June 30, 2007

June 8, 2009
Page 5 of 5

E&Y Response to Recommendation 1a (continued)

- An E&Y professional and regulatory requirement that an executive independent of the audit team reviews all the audit reports contained in the Single Audit reporting package and performs certain other procedures prior to issuance of the reporting package.

E&Y Response to Recommendation 1b

We agree with the recommendation.

E&Y Response to Recommendation 1c

We agree with the recommendation.

We appreciate the opportunity to provide our response to the QCR Report and would welcome discussion of any matters that require further explanation before you finalize the results of your QCR. Please feel free to call me at 614-232-7450 or e-mail me at craig.marshall@ey.com

Respectfully submitted



Craig A. Marshall
Partner

University of Dayton Comments



April 22, 2009

Ms. Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight
Office of Audit Policy and Oversight
Room 833
400 Army Navy Drive
Arlington, VA 22202

Dear Ms. Davis:

We have received your draft report, dated March 26, 2009, regarding the quality control review of the Ernst & Young LLP FY 2007 Single Audit of the University of Dayton. We have reviewed the comment pertinent to the University of Dayton regarding the additional detail needed on the Schedule of Expenditures of Federal Awards and in the Data Collection Form for fiscal year 2007 and have updated both documents as requested. We will file the revised Data Collection Form and audit report with the Federal Audit Clearinghouse once we have received a report with the revised schedules from our auditors.

Sincerely,

A handwritten signature in dark ink, appearing to read "Thomas E. Burkhardt", is written over a horizontal line.

Thomas E. Burkhardt
Vice President for Finance
and Administrative Services

cc: Felicia M. Fuller

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Inspector General Department of Defense

